BACKGROUND ON EQUALIZATION

Manitoba
Finance

OCTOBER, 1984

Purpose of Equalization

Equalization is a national program under which the federal government provides cash payments to the poorer provinces. Its purpose, as defined in the Constitution is to ensure:

> "that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."

The level of equalization has a profound impact on the ability of receiving provinces to provide national calibre programs and services without increasing their taxes.

Equalization Benchmark Reduced

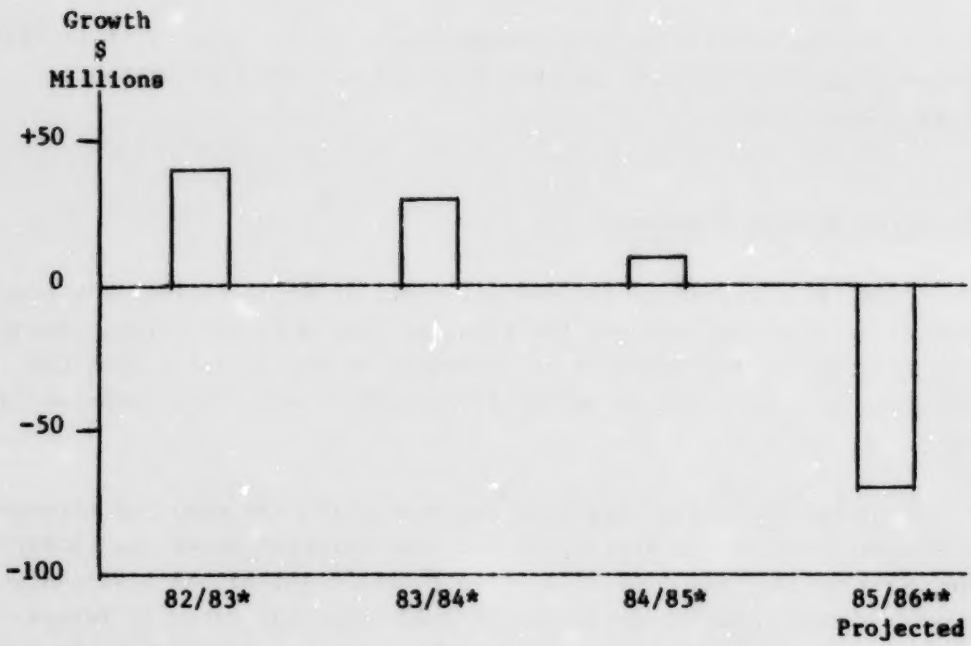
In 1982, to reduce the overall costs of equalization, the federal government unilaterally changed the formula. The most significant change was the lowering of the standard or benchmark of equalization from the all-province national average to the five-province so-called "representative average".

Manitoba remains very much concerned with the damaging effects the lower standard has on the ability of all six recipient provinces (Manitoba, Quebec, Nova Scotia, New Brunswick, Prince Edward Island and Newfoundland) to provide adequate public services and hold their tax rates to levels competitive with the four richest provinces. For Manitoba, the latest available information suggests that the federal equalization formula support falls some $200 per person (over $200 million in total) short of the amounts necessary to bring our revenues up to the national average.

$72 Million Further Cut

For the coming year, rather than closing that gap, current federal forecasts suggest equalization support to Manitoba will be cut by about $72 million. That will happen if the federal government permits the special transitional provisions to lapse.

MANITOBA EQUALIZATION ENTITLEMENTS GROWTH 1982/83 TO 1985/86



* Includes transitional provisions.
** After floor provision.

Source: Federal Department of Finance.

Failure of Transitional Measures

Transitional arrangements were introduced in 1982 to ensure that no province faced an absolute year-over-year loss in equalization as a result of the lowering of the equalization standard. The arrangements covered the first three years of the new formula in the expectation (based on federal forecasts at the time) that entitlements under the formula in the fourth year (1985-86) would exceed the levels guaranteed by transition.

Unfortunately, as is evident in the forecast $72 million decline in Manitoba's equalization support next year, the transitional arrangements have simply failed to achieve their objective.

Impact on Manitoba

The severity of the problem facing our Province is evident in a number of facts.

1. The new equalization formula indicates that Manitoba's need for equalization is increasing by in the 7% to 9% range next year. However, unless transition is extended, Ottawa will cut our support by 15%.

2. Unless transition is extended, Manitoba's equalization support next year is forecast to be 1.2% lower on a per person basis than in 1981/82, the last year of the all-province national average system. (Table 1)

3. Manitoba is the only province forecast to receive less per person next year than 1981-82. In contrast, the other five recipient provinces are to receive increases averaging 19.3% per person compared with 1981/82. (Table 1)

Table 1 EQUALIZATION PER CAPITA ENTITLEMENTS			
	1981-82 $	1985-86 $	% Change*
Manitoba	388	384	-1.2
Five other Recipients	461	550	+19.3
National Total	453	532	+17.4

4. It should be noted that the reduction forecast for Manitoba is to occur despite inflation of about 25% between 1981-82 and 1985-86 and despite the fact that the new formula suggests a one-third increase in Manitoba's equalization need since 1982-83. (Table 2)

Table 2 GROWTH RATES MANITOBA ENTITLEMENT (NEW FORMULA) VS FEDERAL EQUALIZATION SUPPORT TO MANITOBA			
	Formula Growth (%)	Inflation (%)	Payment Growth (%)
1982-83 to 1985-86	+33	25	-7.1
1982-83 to 1986-87	+45	25+	-8.9

5. Unless transition is extended, Manitoba's share of equalization under the new formula is to be cut to 7.0% compared with more than 9% under the previous formula. (Table 3)

6. In total, despite continuing increases in the Province's need for equalization (even under the new formula), Manitoba would receive less in equalization in 1985/86 ($408 million) than in 1982/83 ($439 million), the first year of the new formula. (Table 3)

7. Manitoba is the only province projected by Ottawa to experience a further reduction in 1986/87. (Table 3)

Table 3 **MANITOBA EQUALIZATION ENTITLEMENTS**

	$ Millions	Share of National Total (%)
1981-82	399	9.1
1982-83	439*	9.0
1983-84	467*	9.0
1984-85	480*	8.9
1985-86	408**	7.7
1986-87	400	7.0

*Includes transitional payments of $163, $177 and $142, respectively.
**Includes floor provision of $41.

Urgency for Federal Action

The urgency for prompt federal action is clear. If Ottawa proceeds with the equalization cut, Manitoba's revenue growth will be reduced to $25 million or 0.8%. As our increasing needs measured under the new formula attest, the Province simply lacks the resources to absorb such a cut and prevent it from affecting programs and services for Manitobans.

Manitoba's Proposals

It is our view that we should return to a fair national average standard to ensure equity in our equalization system. However, as an immediate remedy to our problem, Manitoba has proposed that transitional arrangements be extended. Under the provincial request, Manitoba's equalization entitlements would be based on our 1984/85 equalization support increased by half the annual increase in the Province's entitlement for equalization under the formula.

That approach would assure the Province of some increase in its equalization payments commensurate with needs, clearly a much better situation than inflicting major cuts. At the same time, the federal government, in cooperation with the provinces, should re-examine the whole question of equalization with a view to ensuring that its fundamental objectives as enshrined in the Constitution will be met.

SUPPLEMENTARY INFORMATION

THE EFFECT OF FEDERAL TRANSFER PAYMENT CUTBACKS ON MANITOBA

DEPARTMENT OF FINANCE
GOVERNMENT OF MANITOBA
OCTOBER, 1984

Introduction

This paper summarizes available information on the degree to which federal transfer payments to Manitoba have been and are projected to be cut back and the effect these projected cutbacks would have on the Province's fiscal situation in 1985/86.

Established Programs Financing

The Established Programs Financing (EPF) arrangements provide federal support toward the costs of health and post-secondary education programs. The arrangements provide for one block of funding with cash and tax transfer components. The block is escalated by a three year moving average of G.N.P. growth.

In 1982, the so-called Revenue Guarantee component was removed from EPF. In 1983/84 and 1984/85, the portion of the financing arbitrarily deemed by the federal government to be applicable to post-secondary education was capped. Both these measures not only reduced payments in the years in which they were applied, but also reduced the size of the block and therefore, as the escalator is applied to the new reduced base, the cutback is magnified annually. The effects of these measures are shown in Table 1.

Table 1 **EPF CUTBACKS ($ Millions)**

	Revenue Guarantee	PSE Capping	Total
1982/83	35	-	35
1983/84	38	5	43
1984/85	41	11	52
1985/86	45	12	57
1986/87	49	14	63
Five Year Total	208	42	250

Equalization

In 1982, when the federal government changed the equalization formula, Ottawa claimed that its new formula, including transitional provisions, would yield payments to Manitoba of $431 million in 1982-83, $457 million in 1983-84, $470 million in 1984-85, $488 million in 1985-86 and $538 million in 1986-87, for a five year total of $2,384 million.

Compared with estimates of equalization support under the extension of the former system agreed to by all ten provinces, implementation of the new formula provided significantly less equalization support to Manitoba. The forecast losses to Manitoba were $21 million in 1982-83, $78 million in 1983-84, $124 million in 1984-85, $169 million in 1985-86 and $190 million in 1986-87 for a five year total of $582 million.

Table 2 **EQUALIZATION ENTITLEMENTS MANITOBA**
($ millions)

	Old Formula(1)	New Formula(2)	Loss
1982-83	452	431	-21
1983-84	536	457	-78
1984-85	594	470	-124
1985-86	657	488	-169
1986-87	728	538	-190
5 years	2,966	2,384	-582

(1) March, 1982 Concensus Provincial Estimates.
(2) March, 1982 Federal Finance Estimates.

Estimates published with the 1984 Quebec Budget suggested that the new formula would pay Manitoba $2,172 million over the 1982-1987 period compared with the earlier federal estimate of $2,384 million. The lower estimate published by Quebec represents a shortfall of some $212 million under the new system from Ottawa's 1982 estimates.

Table 3 **MANITOBA EQUALIZATION ENTITLEMENTS NEW FORMULA — MARCH, 1982 FEDERAL ESTIMATES VS 1984 QUEBEC ESTIMATES**
($ millions)

	March, 1982 Federal Estimates	May, 1984 Quebec Estimates	Difference
1982-83	431	439	+8
1983-84	457	466	+9
1984-85	470	480	+10
1985-86	488	408	-80
1986-87	538	379	-159
5 years	2,384	2,172	-212

The last available estimates from Ottawa are similar to the Quebec estimates. They suggest a five year total for Manitoba of $2,194 million, or $190 million less than promised by the federal government when the new system was implemented in 1982.

Table 4 **MANITOBA EQUALIZATION ENTITLEMENTS 1982 FEDERAL ESTIMATES VS 1984 FEDERAL ESTIMATES**
($ millions)

	1982	1984	Difference
1982-83	431	439	+8
1983-84	457	467	+10
1984-85	470	480	+10
1985-86	488	408	-80
1986-87	538	400	-138
5 years	2,384	2,194	-190

Whether the shortfall from the 1982 federal estimates is $190 million or $212 million makes little difference from a Manitoba financial perspective. In either case, Ottawa's new formula is delivering substantially less than promised, with accompanying consequences for the Province's finances.

Equalization Transitional Arrangements

It should be noted that the transitional arrangements secured in 1982 to cushion Manitoba in adjusting to the new system protected Manitoba from an even more serious situation. For Manitoba, the new formula itself is producing results about 25% below federal expectations. Fortunately, the transitional arrangements insulated Manitoba from that unforeseen consequence.

Table 5 **MANITOBA EQUALIZATION SUPPORT**
($ millions)

	March, 1982 Federal Estimate			1984 Federal Estimate		
1981-82			392			399
	Formula	Transition	Total	Formula	Transition/ Floor	Total
1982-83	349	82	431	276	163	439
1983-84	401	56	457	290	177	467
1984-85	443	27	470	343	137	480
1985-86	488	-	488	367	41*	408
1986-87	538	-	538	400	-	400
5-Years	2,219	165	2,384	1,676	518	2,194

* Under "floor" provisions, Manitoba's equalization support cannot drop more than 15% year-over-year -- hence the $41 million in 1985-86.

Unfortunately, however, the transitional arrangements also masked the serious failings of the new formula and permitted the federal government to avoid dealing with the problem in 1982-83 or since then. In effect, the transitional arrangements introduced to protect Manitoba provided minimum guarantees for all recipient provinces and meant that the problems with the new formula did not have to be addressed immediately.

$72 Million Equalization Cut

The serious nature of the situation is evident when one examines the year over year changes in equalization.

Table 6 **MANITOBA'S EQUALIZATION — CURRENT ESTIMATES**
($ Millions)

	Total	Manitoba's Share (%)	Change from Previous Year ($)	Change from Previous Year (%)
1982-83	439	9.0	+40	10.0
1983-84	467	9.0	+28	6.4
1984-85	480	8.9	+13	2.8
1985-86	408	7.7	-72	-15.0
1986-87	400	7.0	-8	-2.0

As the table shows, Ottawa now forecasts that Manitoba will lose $72 million or 15% of its entire equalization support next year, and a further $8 million in 1986-87. In both years Manitoba would receive less in total than in the very first year of the formula, 1982-83, hardly an acceptable result after consistent increases in the Province's need for equalization support as measured under the new formula. If Ottawa proceeds with that cut, overall revenue growth in Manitoba will be reduced to 0.8%, or $25 million.

The cutbacks place a severe strain on the provinces and affect their ability to maintain programs while containing tax increases.

Federal Transfer Payment Deficiency

The EPF cutbacks, combined with the general inadequacy of the bloc-funding formula to keep pace with necessary increases in expenditures to maintain quality health care and post-secondary education programs, have resulted in the federal share of Manitoba expenditures on these programs dropping from 54% in 1979/80 to 43% in 1984/85. The EPF transfer payments now fall approximately $100 million short of what would be required for equal sharing in the costs of these programs as shown in Table 7.

Table 7 **ESTABLISHED PROGRAMS FINANCING (EPF) ARRANGEMENTS GOVERNMENT OF MANITOBA ($ Millions)**

	Total Manitoba Expenditures on Health and Post-Secondary Education	50% of Manitoba Expenditures	Federal EPF Contribution (Cash plus Tax)	Deficiency from Equal Cost-Sharing
1982/83	1,191	596	511	85
1983/84	1,334	667	569	98
1984/85	1,429	714	617	97

The equalization program as currently formulated leaves equalization recipient provinces with revenue capacities well below the national average. For Manitoba in 1985/86 that deficiency translates into $277 million (see Table 8). Thus even without the $72 million cut, Manitoba's revenue would fall about $200 million below what the Province would receive if the formula provided equalization to the ten-province average standard.

Table 8

EQUALIZATION ENTITLEMENTS
GOVERNMENT OF MANITOBA
($ Millions)

	Formula			Deficiency From Ten Province Standard	
	Ten Province Standard	Five Province Standard	Five Province Standard plus Transition and Floor	Five Province Standard	With Transition and Floor Provision
1982/83	491	276	439	215	52
1983/84	543	290	467	253	76
1984/85	608	343	480	265	128
1985/86	685	367	408	318	277
1986/87	740	400	400	340	340
Five Year Total	3,067	1,676	2,194	1,391	873
As % of Ten-Province Standard	100	55	72	45	28

The erosion in federal support is also evident in the share of the federal Budget devoted to these transfers. Certainly, federal transfers have not been a contributor to increases in the federal deficit. In fact, federal projections indicate that EPF and equalization payments will fall from 19.4% of federal spending excluding public debt charges in 1981-82 to 16.9% in 1985-86. A similar decline is evident in federal transfers as a proportion of Manitoba's revenue -- from 42.7% in 1979-80 and 38.4% in 1981-82 to 35.9% in 1984-85 and even less next year.

In short, federal transfers have been significantly eroded as a share of the federal Budget, as a share of the Manitoba Budget and as a share of overall program costs.

Urgency for Federal Action

For 1985/86, if Ottawa proceeds with the $72 million equalization cut, overall revenue growth in Manitoba will be reduced to 0.8%, or $25 million.

There are several good reasons why that cut should not be permitted to occur -- the main one being its impact on provincial programs and services. Available federal forecasts indicate a significant increase in Manitoba's need for equalization support next year. Yet, Ottawa plans to cut its equalization support to Manitoba by 15%, or $72 million. Next year, Manitoba's per capita equalization suport would be 1.2% lower than 1981-82. In contrast, the other recipient provinces are to receive 19.3% per person more than 1981-82. Manitoba's share of equalization would drop to 7% compared with over 9% in the 1977-1981 period.

Over the last three years, Manitoba's spending, which included significant recession-fighting and economic rebuilding initiatives, has been held to significantly lower growth rates than under the former administration. In the last Tory year, 1981-82, Manitoba's spending increased by 18.2%. Since then, the spending growth rate has been held to successively lower levels -- 16.9% in 1982-83, 13.5% in 1983-84, and 7.2% this year. By the same token, Conference Board analysis of this year's Provincial budgets confirms that Manitoba's spending at $3,111 per person is third lowest among the provinces and close to 9% below the all-province average. That analysis supports the view that Manitoba has succeeded in accommodating major initiatives to enhance the economy within one of the country's lowest per capita spending rates.

The economy of Manitoba has improved. Provincial spending growth has been contained. Where necessary, taxes have been increased. Nonetheless, the challenge facing the Province next year would be difficult even if federal support were maintained. However, the situation will be much more serious if Ottawa proceeds with the termination of the transitional arrangements in the equalizaton program. The resulting cuts would reduce already moderate revenue growth for Manitoba of about 3% to under 1%.

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